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RUEHBJ/AMEMBASSY BEIJING 1951
RUEHLM/AMEMBASSY COLOMBO 0056
RUEHKA/AMEMBASSY DHAKA 0069
RUEHIL/AMEMBASSY ISLAMABAD 0534
RUEHBUL/AMEMBASSY KABUL 0352
RUEHKT/AMEMBASSY KATHMANDU 0066
RUEHNE/AMEMBASSY NEW DELHI 0223
RUEHOT/AMEMBASSY OTTAWA 0129
RUEAIIA/CIA WASHDC
RHEFDIA/DIA WASHDC
RUEKJCS/OSD WASHDC
RHEHNSC/NSC WASHDC
RUCPDOG/USDOC WASHDC 0556
RUEKJCS/SECDEF WASHDC
RUEKJCS/JOINT STAFF WASHDC
RUEHGV/USMISSION GENEVA 0472
RUEHVEN/USMISSION USOSCE 2362
RUCNDT/USMISSION USUN NEW YORK 1746
RUEHNO/USMISSION USNATO BRUSSELS BE
RUEHBS/USEU BRUSSELS
RUEHLMC/MILLENNIUM CHALLENGE CORP
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL

C O N F I D E N T I A L SECTION 01 OF 03 BISHKEK 000155

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DEPT FOR SCA/CEN (GEHRENBECK)

E.O. 12958: DECL: 02/09/2017

TAGS: [EMIN](#) [ECON](#) [EINV](#) [KG](#)

SUBJECT: THE GLITTER OF KYRGYZ GOLD TAXES CANADIAN MINE
OPERATOR

REF: A. 06 BISHKEK 1692

[1](#)B. BISHKEK 080

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Classified By: Charge d'Affaires Lee Litzenberger for Reasons 1.4 (b) and (d)

[1](#)1. (C) Summary: The Canadian-run Kumtor gold mine in eastern Kyrgyzstan, which generates 4-6% of Kyrgyz GDP, is expected to double its 2006 production of 303,000 ounces by 2008. Despite the rosy projections, Kumtor Operating Company (KOC) President Andrew Lewis told Embassy that a less friendly attitude towards KOC under President Bakiyev's administration enabled "petty" efforts to extract more revenue from KOC in contravention of KOC's existing operating agreement. In addition to problems with officials, annual staff turnover of 10%, coupled with a declining pool of qualified subcontractors, complicate KOC's activities. KOC's prominence, in the face of growing regional interest in Kyrgyzstan's mineral resources and the desire to derive more revenue from KOC, highlights the company's role as a bellwether for the investment climate for western firms operating in Kyrgyzstan. End summary.

The Raw Figures

[1](#)2. (U) During a January 9 lunch, executives of Kumtor Operating Company (KOC), a subsidiary of the Canadian firm Centerra Gold, Inc., provided Embassy with an update of its operations at the Kumtor gold mine in eastern Kyrgyzstan.

The Kyrgyz government, through its own gold mining entity Kyrgyzaltyn, owns a 16% stake in Centerra valued at approximately \$380 million.

¶3. (SBU) KOC's Kumtor gold production annually generates roughly 4-6% of Kyrgyz gross domestic product (GDP). A rock slide and the processing of lower-grade ores in 2006 reduced Kumtor production to 303,000 ounces, and depressed overall GDP. KOC President Andrew Lewis credited \$116 million in recent on-site investments for forecasted increases in production to 460,000 ounces in 2007 and 630,000 ounces in ¶2008. This uptick in production could increase Kyrgyz GDP by one or two percentage points.

Changing Fortunes: Mining in the Bakiyev Era

¶4. (C) Despite the rosy production forecasts, Lewis contrasted his firm's good relations with former President Akaev's regime to problems caused by officials associated with President Bakiyev, who, he claimed, employ increasingly "petty" tactics to squeeze more money out of KOC. He could not identify any KOC "champions" within the current government, and instead identified Parliament's Vice Speaker Kubanychbek Isabekov, who hails from the Kumtor region, as a prominent adversary. (Note: Isabekov is not related to newly-installed Prime Minister Azim Isabekov. But, he has enjoyed regular individual consultations with Bakiyev. End note.) Isabekov supported additional revenue demands that, in KOC's view, violate KOC's existing agreement with the Kyrgyz government. As an example of Isabekov's interference, Lewis recounted a case in which the Kyrgyz Supreme Court rendered a decision within ten minutes favoring the Kyrgyz government in a dispute with KOC. Lewis said he later

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learned that Isabekov has a deciding role in the nomination and approval of Supreme Court judges.

Fleeing the Golden Goose?

¶5. (C) The Supreme Court case involved land use tax. Lewis argued that a clause in KOC's agreement allows it to opt out of any changes in government policy affecting Kumtor operations for a ten-year period through 2014. A July 2006 official decree required land lessees (like KOC) to pay land tax. KOC paid the 46 million som (\$1.16 million) assessment in order to avoid foreclosure proceedings. Lewis said KOC considered taking the case to international arbitration in Stockholm, but was threatened with talk of "nationalization."

He then quoted Acting First Deputy Prime Minister Daniyar Usenov stating that "if we obtain more money out of Kumtor, then we will not need HIPC." (Note: Usenov has openly expressed his opposition to the HIPC debt relief program. There has been some media reporting of parliamentary disagreement over the Kumtor contract; however, there have been no overt demands for expropriation. See refTel B for more on HIPC. End note.)

Prospects for the Future

¶6. (C) KOC Vice President for Materials and Compliance (Amcit) Sanford Stephens and Environment Director Rodney Stuparyk revealed that roughly 10% of KOC's 2,300 employees leave the firm annually. Trained staff are joining the exodus of Kyrgyz citizens seeking more lucrative jobs in Russia and Kazakhstan. Stephens, who has worked in Kyrgyzstan for nearly a decade, also described a declining pool of trained contractors. Contractors, he observed, failed to invest in new equipment for fear of attracting the attention of tax authorities. Despite frequent requests from international credit institutions, Stephens is unable to identify potential loan applicants because KOC's subcontractors fear the attention of authorities.

17. (C) In a worsening environment of official corruption, Stephens admitted "contracting out" license and permit renewal functions to local Kyrgyz firms. This outsourcing, Stephens argued, allowed KOC to reduce direct requests for nonofficial payments.

Other Gold Mining Operations

18. (SBU) Lewis discussed other players in the Kyrgyz gold mining industry. Kyrgyzaltyn, the state-owned gold mining firm, produces approximately one metric ton (or roughly 35,273 ounces) of gold annually from two mines. (Note: Kyrgyzaltyn operates the Makmal mine near Jalalabad. However, we understand that Kyrgyzaltyn's second mine at Taldybulak near the northern town of Kemin is currently inactive. End note.) The Jerooy gold mine in the Talas region remains mired in an ownership dispute between UK-based Oxus Gold and Global Gold, with Kyrgyzaltyn a partner in each company's joint venture. Environmental questions are troubling operations at another Talas mine (at Andash). Other firms recently active in Kyrgyz gold exploration include Central Asian Gold, Summer Gold and Eurasian Minerals. Kyrgyzaltyn also maintains a network of bureaus to

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purchase gold discovered by individual prospectors.

Comment

19. (C) KOC benefited from its relationship with Bakiyev's predecessor, but now is seen less as a valued investor and more as a source for revenue. Despite the land tax and a recent pay increase for staff forced by government officials, KOC has continued operations in a very profitable business. In an environment where Chinese, Kazakh and Russian interests are rapidly expanding their control of Kyrgyzstan's mineral wealth, KOC is a bellwether of the investment climate for western firms in Kyrgyzstan. While regional investors become larger players in Kyrgyzstan, KOC also must remain attuned to moves by the authorities in Bishkek. If Kyrgyz officials, led by Acting First Deputy PM Usenov, succeed in liquidating Kyrgyzstan's 16% stake in KOC's parent company Centerra for the ostensible benefit of a proposed Kyrgyz development fund, Kumtor may become a tempting, and proven, target for Kyrgyz officials seeking additional revenues for public, or possibly private, consumption.

LITZENBERGER